

Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 SP-02 USIA-06 AID-05 EB-08
NSC-05 SS-15 STR-07 OMB-01 CEA-01 CIAE-00 COME-00
FRB-03 INR-10 NSAE-00 XMB-02 OPIC-03 LAB-04
SIL-01 /096 W
-----073940 011224Z /21

R 312102Z MAR 78
FM AMEMBASSY BONN
TO SECSTATE WASHDC 7250
DEPARTMENT TREASURY
INFO AMEMBASSY BRUSSELS
AMEMBASSY LONDON
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
USMISSION USBERLIN
USMISSION USNATO
AMCONSUL FRANKFURT
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USEED, USOECD ALSO FOR EMBASSY
DEPARTMENT PASS FRB AND CEA

E.O. 11652: N/A
TAGS: ECON, EFIN, GW
SUBJECT: EMBASSY PROJECTION OF 1978 GERMAN GNP

1. SUMMARY -- WE SEE A MODERATELY BETTER PERFORMANCE
FOR THE GERMAN ECONOMY IN 1978, BUT DOUBT MUCH IF ANY-
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THING WILL BE ACHIEVED TOWARD SELF-SUSTAINING GROWTH,
STRONGER PRIVATE INVESTMENT AND REDUCED UNEMPLOYMENT.
CURRENTLY, GENERAL SATISFACTION CAN ONLY BE TAKEN WITH
A STEADILY LOWER RATE OF INFLATION, IN PART INDUCED
BY IMPROVED TOT AND NARROWER PROFIT MARGINS. HOWEVER,
EXCESSIVE MONETARY EXPANSION TO COMBAT PRESSURE ON
THE DM RATE COULD LATER TARNISH THE FRG'S MUCH VAUNTED

RECORD FOR PRICE STABILITY. BITTER WAGE NEGOTIATIONS AND EXCHANGE RATE TURBULANCE HAVE INDUCED A PESSIMISTIC MOOD ABOUT THE ECONOMY. EARLY AND MODEST WAGE SETTLEMENTS WOULD TEND TO SWING SENTIMENT TOWARD SOMEWHAT GREATER OPTIMISM. EVEN NOW THERE ARE POSITIVE INDICATORS. PUBLIC SECTOR OUTLAYS ARE HELPING TO BOOST ECONOMIC ACTIVITY; CONSTRUCTION ACTIVITY IS ON THE UPSWING. END SUMMARY.

2. BELOW ARE THE EMBASSY'S PROJECTIONS OF CHANGES IN THE PRINCIPAL MACROECONOMIC AGGREGATES FOR 1978 AND PRELIMINARY RESULTS FOR 1977:

ESTIMATED 1978 GROWTH OF GERMAN GNP
1970 PRICES

1977 P/ 1978

1ST HALF 1/ 2ND HALF 1/ YEAR

PRIVATE CONSUMPTION	2.9	1.3	1.0	2.9
PUBLIC CONSUMPTION	0.7	1.8	1.5	3.0
FIXED INVESTMENT	2.7	2.5	2.1	3.5
INVENTORIES				
(DM BILLION)	8.7	6	4	10.0
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NET FOREIGN BALANCE

(DM BILLION)	26.0		25.1
EXPORTS	4.2	2.3	2.2 4.5
IMPORTS	4.2	2.5	2.1 5.5
GNP	2.4	2.3	1.0 3.0

PRICE DEFLATORS:

CPI	3.9		3.2
GNP	3.7		3.0

PRODUCTIVITY

(PER EMPLOYEE)	3.0		3.5
WAGES (INCLUDING			
FRINGE BENEFITS)	6.8		6.2

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1/ SAR PERCENTAGE CHANGE OVER PREVIOUS HALF YEAR

3. GNP

FOURTH QUARTER 1977 TO FOURTH QUARTER 1978 GNP GROWTH
WILL PROBABLY HAVE TO BE IN THE FOUR PERCENT RANGE TO
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GET YEAR-OVER-YEAR GROWTH TO 3.0 PERCENT. THAT WOULD
NOT BE ENOUGH TO DO ANYTHING MUCH FOR THE UNEMPLOYMENT
OR FOR CAPITAL UNDERUTILIZATION BUT WOULD BE A LOT
BETTER THAN LACKLUSTER. DOUBTS CENTER NOT SO MUCH
ABOUT WHETHER THE FRG WILL HAVE A FAIRLY EXPANSIVE
ECONOMY IN 1978 AS TO WHETHER IT WILL BE STRONG ENOUGH
TO BE SELFSUSTAINING. THE ECONOMY PICKED UP WELL IN

THE FOURTH QUARTER. AN EXPANSIONARY PUBLIC SECTOR AND TAX REDUCTIONS FOR 1978 PROVIDE BOTH REAL AND PSYCHOLOGICAL UPLIFTS, ESPECIALLY FOR THE FIRST HALF OF 1978. NEVERTHELESS, BUSINESS CONFIDENCE SEEMS TO BE WEAKENING AGAIN NOW AND CONSUMER SPENDING CONTINUES SOFT. IN OUR JUDGMENT THE MEASURES SO FAR TAKEN WILL NOT SUFFICE TO KEEP THE ECONOMY MOVING AT A SATISFACTORY PACE. THAT DOES NOT NECESSARILY IMPLY A REPEAT OF 1977. A RAPID END TO THE WAGE NEGOTIATIONS AND STEADIER EXCHANGE MARKETS COULD PROVIDE A RESPITE DURING WHICH INVESTOR AND CONSUMER CONFIDENCE WOULD RISE. EVEN SO, WE DO NOT DETECT STRONG UNDERLYING MOVEMENTS IN THE ECONOMY WHICH WOULD CARRY IT STEADILY FORWARD.

4. CONSUMPTION

PRIVATE CONSUMPTION WILL BE BUOYED BY PERSONAL INCOME TAX CUTS OF DM 11 BILLION AND BY HIGHER WAGE AND NONWAGE INCOMES. WE BELIEVE THE RISE IN WAGE COSTS WILL PROBABLY EXCEED THE OFFICIAL ESTIMATE OF 5.5 PERCENT BY AS MUCH AS ONE HALF TO ONE PERCENTAGE POINTS. OUR ASSUMPTIONS ABOUT HIGHER NOMINAL WAGES IMPLY A SMALLER INCREASE IN ENTREPRENEURSHIP AND PROPERTY INCOME THAN THE OFFICIAL ESTIMATE OF 11-13 PERCENT. DISPOSABLE INCOME SHOULD THUS RISE BY ABOUT 7-8 PERCENT (ALL LIMITED OFFICIAL USE

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NOMINAL). A FALLING INFLATION RATE (AT LEAST THROUGH MOST OF 1978) SHOULD ALSO HELP TO RAISE REAL CONSUMPTION EXPENDITURES. ON THE OTHER HAND, THE UNLOCKING OF SMALLER AMOUNTS OF STATUTORY SAVINGS AND A POSTPONEMENT OF OLD AGE PENSION INCREASES WILL HAVE SOME DAMPENING IMPACT ON CONSUMPTION.

5. INVESTMENT

OTHER FORECASTERS HAVE PUT FIXED ASSET INVESTMENT BETWEEN 3.5 AND 5 PERCENT. WE DOUBT THAT IT WILL RISE MUCH ABOVE THE LOWER LIMIT OF THIS RANGE. GROWTH OF THIS SECTOR HINGES STRONGLY ON HOW FAST INVESTMENT PROGRAMS ARE FREED FROM ADMINISTRATIVE, LEGAL AND ENVIRONMENTAL RESTRAINTS. FRG ESTIMATES A 6.5 PERCENT REAL INCREASE IN PUBLIC SECTOR INVESTMENT WHICH APPARENTLY REFLECTS EXPECTATIONS FOR FAIRLY SMOOTH SAILING IN 1978.

ECONOMIC INSTITUTES, COUNCIL OF ECONOMIC EXPERTS, GOVERNMENT AND BUSINESS HAVE ENDORSED WAGE MODERATION (THOUGH NOT COMPLETELY IN AGREEMENT ON EXACTLY HOW MUCH)

AS ESSENTIAL TO THE ENCOURAGEMENT OF INVESTMENT. THE
LABOR UNIONS, HOWEVER, ARE TAKING A TOUGH STAND FOR
WAGE INCREASES WHICH WOULD EXCEED THE FIVE PERCENT
MAXIMUM RECOMMENDED BY THE COUNCIL AND INFERENTIALLY
ENDORSED BY THE GOVERNMENT. WHAT IS NOT CLEAR IS THE
IMPACT WAGE MODERATION WOULD HAVE ON INVESTMENT,
PARTICULARLY SHOULD IT BE BOUGHT WITH MANAGEMENT
CONCESSIONS ON JOB SECURITY. ALTHOUGH BUSINESS INCOME
INCREASED ONLY NOMINALLY IN 1977, THE RECEIPT OF INVEST-
MENT CREDITS ON PAST INVESTMENT OUTLAYS AND SLACK
INVESTMENT OUTLAYS IN 1977 ENABLED THE BUSINESS
SECTOR TO BECOME VERY LIQUID IN RECENT MONTHS. MOREOVER,
INVESTMENT FUNDS CAN BE OBTAINED VERY CHEAPLY.
HOWEVER, ONE ROUND OF WAGE MODERATION PROBABLY WOULD
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HAVE ONLY LIMITED IMPACT ON EXPECTED PROFITS FROM NEW INVESTMENT, GIVEN MUCH SPARE CAPACITY. BARRIERS TO THE EFFICIENT EMPLOYMENT OF LABOR AND TO REDUCTIONS IN LABOR COSTS THROUGH LAYOFFS COULD AFFECT LABOR-SAVING INVESTMENTS WHICH HAVE BEEN VERY SUBSTANTIAL IN RECENT YEARS.

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6. FOREIGN TRADE

WE EXPECT EXPORT VOLUME IN 1978 TO EXPAND AT ABOUT 4.5 PERCENT. FORECASTERS ARE IN GENERAL AGREEMENT THAT, DESPITE MARK APPRECIATION, GERMAN EXPORTS IN 1978 SHOULD KEEP PACE WITH THE LEVEL OF WORLD TRADE. THEY WORRY ABOUT EXCHANGE RATE INSTABILITY INDUCING MORE PROTECTIONISM, BUT IN THAT EVENT WORLD AS WELL AS GERMAN TRADE WOULD SUFFER. WE EXPECT IMPORT VOLUME TO GROW BY ABOUT 5.5 PERCENT. THIS ESTIMATE IS CONSISTENT WITH GROSS NATIONAL INCOME EXPANSION IN THE 3 PERCENT RANGE AT HISTORICAL INCOME ELASTICITY VALUES.

7. EMPLOYMENT

WITH WORKER PRODUCTIVITY ASSUMED TO BE EXPANDING AT ABOUT THE SAME RATE AS GNP OVER THE COURSE OF THE YEAR, THE WORK FORCE WILL HAVE TO REMAIN ALMOST CONSTANT TO KEEP UNEMPLOYMENT FROM RISING. NET EMIGRATION OF FOREIGN WORKERS AND WITHDRAWALS (INCLUDING MARGINAL JOB SEEKERS) FROM THE WORK FORCE SHOULD KEEP INCREMENTS TO THE WORK FORCE AT A LOW LEVEL. WE SEE THE UNEMPLOYMENT RATE REMAINING STEADY IN THE 4.5-4.7 PERCENT RANGE.

8. OUR PROJECTIONS ARE BASED ON CURRENT FRG MACRO-ECONOMIC POLICIES. THEY ARE ALSO SUBJECT TO THE USUAL CAVEATS REGARDING INTERNATIONAL ECONOMIC STABILITY

AND PRICE STABILITY OF IMPORTANT COMMODITIES.

STOESSEL

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